FUNDAMENTAL INVESTMENT PRINCIPLES

Fundamental Investment Principles

PUBLISHED BY THE
INVESTORS PUBLISHING COMPANY
CHICAGO, ILLINOIS

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PRELIMINARY

Do not Read this Book but once and Cast it Aside.

This is a Permanent Reference Work.

It Means Dollars and Cents to You.

It Must be Studied Conscientiously.

CHAPTER I.

FOREWORD

The object sought and the value claimed for this compilation is based upon the assumption that information, which hundreds of people have actually asked for, concerning stocks, bonds and all kinds of securities, may be of interest and helpful to thousands of others. Studious application to the teachings given and a careful and persistent adaptation of the same, whenever one is approached with investment offerings, will unquestionably minimize the elements of risk and avert the dangers of loss.

Millions of dollars worth of stocks and bonds for new enterprises are yearly offered for sale and a proper

selection is, in itself, a difficult task, especially for the inexperienced; becoming even more complicated when the requirements to suit the circumstances of the individual investor are taken into consideration. What will meet the demands of the rich rancher will not be suited for the savings of a small merchant or of a teacher. Some desire an investment for a long period—others prefer short term securities, for the temporary employment of their funds.

The principles of investing are set forth herein as simply as possible in plain, concise lay language, to enable those who take the ordinary precautions, to avoid the many pitfalls with which they are confronted in search of a larger interest income than that offered by savings banks.

In these days we find a most extensive range in offerings of investments. Everything from fraudulent business ventures to government bonds is trademarked "An Investment." It is re-

markable that the public does not discriminate between real, conservative, carefully chosen securities and some of the most impossible schemes.

Men and women practice economy and self restraint for years in order to store up a competence and accumulate their savings for use in old age; yet hundreds of these people meet with financial ruin because of some scheme which promises a magical transformation of their savings into untold riches.

The tendency to get something for nothing, a desire for exceptional bargains and the acquirement of sudden wealth, is deeply rooted. Although a great many unscrupulous parties are frequently exposed by prosecution, *et cetera,* there are always some persons quite ready to risk their savings on apparent investments which promise to work wonders and multiply money hourly.

Speculation is nothing but pure unadulterated gambling and covers every-

thing which has no proven value. It should be absolutely discountenanced. It includes all moneys advanced to enterprises to be created, to alleged discoveries, to uninvestigated ventures, to unpatented inventions and to companies in the course of formation.

Obviously, therefore, persons with only small and moderate means should place their savings in a bank, the only logical place, until enough money with which to buy a conservative bond has been accumulated. To find a good savings bank is not very difficult, but in ANY savings bank there is less risk than in the majority of so-called investments. It does not need a mathematical demonstration to show that the interest paid by savings institutions is of necessity small. The low rate of interest is proof of their excellence. Avoid savings banks which offer an unusual interest; in other words, more than three or four percent, because banks offering a greater rate are apt to be unsound.

General Remarks on the First Accumulation of Funds

Savings institutions cannot pay a large rate of interest, as their investments are regulated, restricted and prescribed by special laws in most states and the list of their investments contains only approved securities. However, the very fact that a security is legal for savings banks investments, does not necessarily insure absolute security. For instance, in the New England States securities of railroads operating in that territory were legal for savings banks for years but today are regarded as a speculation rather than an investment. In considering savings banks, those with good, careful, conservative management are to be chosen. It is an easy matter to obtain satisfactory information regarding these.

When at least five hundred to one thousand dollars has been accumulated, it is advisable to look for a time-tested,

substantial investment which provides a larger income than may be secured from the rate of interest paid on savings banks deposits. It cannot be too strongly emphasized, that when such a step is anticipated, one should devote considerable attention to the indispensable elements of safety and establish conclusively, the stability of the enterprise about to be selected. Do not omit these precautions, otherwise your venture may prove disastrous. Acquire and collect the most complete information possible. Remove the veil and reveal the reality. These basic considerations comprise the fundamental steps which prevent regret, worry and loss.

Place insistence on safety of principal above everything else, for this must be the determining factor at all times, notwithstanding that an attractive rate of interest may be offered. Do not allow the interest rate to influence you in your selection.

Remember, it was difficult to save the nucleus of the principal. Follow these suggestions and study the following questions constantly, applying them to investment offerings as the keynote to the selection of a safe, sane and desirable investment.

Test Questions

1 Under what laws is the charter granted?

2 Why is the company incorporated?

3 Is the business legitimate and has it real merits, or is it visionary?

4 Are you familiar with the business?

5 Is this concern a new venture or in the course of construction?

6 Has there ever been a failure in this company or is there a great danger of failure in similar companies.

7 Does the business pay in other localities?

8 Are there appreciable risks?

9 Are there large companies with which to compete?

10 Why is the business more advantageous than that of its competitors?

11 Is the company manufacturing necessities or luxuries which are in general use? A concern manufacturing luxuries may not be able to pay dividends on account of greatly reduced earnings during a business depression.

12 How large is the capital?

13 How many shares have been sold and paid for, traded in, given away as bonus or exchanges for property, patents (there are many pitfalls in patents even if allowed by the government), trademarks, charter rights, franchises, and goodwill? This last asset being a rather uncertain quantity.

14 If shares have been sold, did they bring a full price; in other words, was the par value of the shares real-

ized and who received the money which was paid for such shares?

15 How much stock is subscribed for and can all of the stock be sold?

16 What assurance exists that sufficient capital is available to carry on the business successfully and adequately? A large percentage of failures is attributed to the lack of capital.

17 Is there any liability to the stock? Never buy industrial stocks if the shares are assessable. All bank stocks carry liability equal to twice the par value of shares.

18 Has the company liabilities?

19 Of what do the assets consist?

20 Is the nature of the business a risk or is it of a perpetual nature?

21 Is there any doubt as to the marketability of the finished product?

22 Can the raw material be easily procured?

23 Where is the source of the raw material and who controls its output?

It is important to determine whether or not competitive companies control or have an interest in the raw material supply.

24 Do items enter in, such as long drayage, *et cetera,* which may make the prices higher than competitive goods, and so retard their sale?

25 Is the output uniform? If not, can other articles be manufactured so that the organization may continue work during slack seasons?

26 Is there a steady demand for the goods produced?

27 What are the labor conditions; have there been any difficulties, strikes, *et cetera,* in the community where the enterprise is located? Is the company paying lower wages than competing companies, which may cause strikes later?

28 Can sufficient help be had to carry out the enterprise without hindrance?

29 Are the freight rates prohibitive, and will they influence the price of the finished article?

30 Does the possibility exist that the Interstate Commerce Commission will interfere with rates or regulate them so that the earning of dividends will be practically impossible? This pertains especially to the case in steam and electric railroads, telephone, electric light and gas companies.

31 Could tariff laws or special revenues upset former calculations as to profit?

32 Is the company involved in law suits? If so, are amounts set aside to provide for such contingencies? This last item would show foresight on the part of the management.

33 Are sufficient orders on hand, and does prospective business warrant immediate expectation of dividends?

34 What are the prospects of paying dividends?

35 If the company has property has there been an examination of the title by prominent attorneys and has it been found clear? Are the titles insured?

36 Are there mortgages, and if so, who holds them?

37 What interest do they bear and when do they mature?

38 Do these mortgages decrease the value of the stock materially?

39 Is there an existing bond issue conveying all the property and other assets to a trustee?

40 Has the property been impartially appraised by competent parties?

41 Have the books been audited by public accountants?

42 What are the basis of inventory valuations? Are they at cost or at market value, and which is the lower?

43 Do they include any unsalable or obsolete articles? If so, is a suffi-

cient reserve appropriated to cover these?

44 Is there included an element of anticipated profit and has proper reserve been provided against it?

45 Does the machinery belong to the company or is it leased as in the case of shoe factories, where machinery is only leased?

46 If the property consists of factory equipment, how much may be realized if auctioned piecemeal? Remember, machinery, buildings, *et cetera,* of factories have little value except to similar enterprises or as a going concern; their value depending on their use.

47 Is the equipment new? If old, how much has the company written off yearly for depreciation?

48 What is the amount of liquid assets, that is, the excess of current assets over the current liabilities exclusive of the amount of bills payable?

49 What is the proportion of the interest of stockholders as compared to that of note holders?

50 How large are the accounts payable and receivable?

51 Are all accounts receivable collectible?

52 Are they secured?

53 How much merchandise is on hand?

54 How much finished product and how much raw material?

55 Does the company issue periodical statements of its earnings?

56 If an old business, is it to be enlarged? You should know if the money paid in for new shares will be used to wipe out an old indebtedness.

57 If the business is an outgrowth of another business or a consolidation or reorganization of several concerns, how is the present value of the assets to be gauged? Consolidation of companies is frequently accompanied by a large increase in capi-

talization; as for instance in the United States Steel Company, the Woolworth Company, *et cetera.* Competing companies are consolidated for the purpose of eliminating competition, to minimize expenses, reduce the cost of operation, to introduce more economical administration, *et cetera.*

58 Has the business paid profits prior to its reorganization, enlargement or incorporation?

59 How much commission is paid for selling stocks and bonds of this company?

60 Who owns the controlling interest?

61 In what state of repair and condition is the property?

62 Do the preferred stockholders enjoy the right to vote?

63 Are they to be consulted before a larger indebtedness is to be incurred, such as bonds, mortgages, *et cetera.*

64 If the preferred stockholders are not allowed the right to vote at the

annual stockholders meeting, will they receive this privilege in accordance with the by-laws, if the dividends are not paid?

65 What privileges does the preferred stock enjoy?

66 May dividends be paid on the common stock which would reduce the total value of the net quick assets?

67 May the preferred stock be increased without the consent of the old holders of preferred stocks?

68 Are the dividends of the preferred stock cumulative?

69 Have the officials connected with the company been failures in other concerns? Success or failure of a venture depends largely on the ability of the management.

70 Are the officers of the company competent, conservative business men?

71 Is the person assigned as treasurer capable and responsible and is he properly bonded?

72 Are the dividends to be paid seemingly high? Companies which must pay an abnormally high interest to procure the necessary capital may be weak in credit, or it may be difficult to finance the enterprise.

Fundamental Considerations

Apply to all offerings the strictest test and eliminate all speculative factors. In considering a suitable investment do not seek a bargain. Never buy because you can do so at a discount. If a company is in poor financial condition, its securities will ordinarily sell below par and such being the case, a bonus will be offered by way of inducement to buy, which will give the purchaser either the par value at redemption or an amount above par.

Scrutinize carefully every offering. No one will give something for nothing. Charity motives do not enter into business transactions. Confidence, trust

and faith are not convincing arguments. Make the most stringent investigation and be sure you receive the most complete information. Determine accurately the reliance to be placed upon all statements. Of equal importance is the asking of references and a cultivation of the habit of looking them up.

In fact, verify all statements regarding the salesmen and broker of the bond house offering you investments. Never jump at conclusions. Do not risk your savings in any investment without first having made the most exhaustive and painstaking investigation.

Do not misjudge opinions, expectations and mere assurances expressed in circulars and pamphlets. Decline to accept them for cold facts. A Prospectus is a temptingly printed circular for the purpose of attracting you.

The general plan of an investment may be meritorious; it may appeal to you, but do not make your decision when your enthusiasm is at its height;

hesitate and familiarize yourself thoroughly with the details. Never act on the spur of the moment. Do not feel assured that you have found an unusually profitable investment.

The man of large fortune, who has the greater part safely invested in sound securities, may be able to gamble a little on new ventures. That is, he may buy stock, to a limited extent, in companies which have an apparently prosperous future. But the man who has but limited means cannot afford to take such a chance. He must be safe first. The prospects of large profits must not lure him. Good bonds should attract him rather than stocks.

Exercise the utmost precaution when considering the purchase of mine or oil stocks, in fact, abundant reasons exist why they should never be bought. There is an ever-prevailing risk in investments of this character, for they are constantly consuming themselves. These stocks are usually offered with

the plea that the property is located near a similar property of established value. More money has been lost in worthless mines and oil fields than has been taken out. There are, of course, a great many good gold, silver, copper and other mining stocks on the market; but the good ones are not frequently offered to the public.

It is advisable to avoid distant investments, for it is difficult and often impossible to obtain reliable information concerning them. People in these distant localities also have surplus funds to invest. Why is the security not offered there for sale? The securities of companies who do not enjoy a wide reputation should be avoided.

Banker's Advice

When you are about to invest, consult your banker. Consider his advice. He is in the business of investing and is better acquainted with the pitfalls. When proper precautions are taken in

advance little fear need be entertained for the safety of the money invested.

List of Investments Should Be Classified

Diversify your list of investments and select one of absolute integrity of both principal and interest. There are listed and unlisted securities. Reference will be made to these later. Be it sufficient to mention, the mere fact that securities are listed affords no guarantee that they will not fluctuate and that the principal cannot be lost, or in some cases, that even the interest will be paid. The great advantage of listed securities is that they may be more easily negotiated; but there are cases when a quick sale cannot always be made even of listed securities.

Redeemable Securities

Redeemable securities, commonly called bonds, will be considered first. Bonds are certificates of indebtedness

issued by private corporations, municipal and government bodies. When a government, state, county or municipality requires money with which to build administration buildings, such as custom houses, court houses, city halls, school houses, water works, sewers, electric works (where the same are owned by cities or towns), pumping stations, *et cetera,* they issue promises to pay at a certain time and to pay interest at certain intervals in order to secure the necessary funds. These promises are certificates of indebtedness and are called bonds.

BONDS

CHAPTER II.

Text of a Bond

The text of a bond should contain: the number; amount of the bond; date of maturity; promise to pay in gold; place of payment; promise to pay interest; rate of interest; where, when and how payable; amount of total bond issue; whether coupon or registered; how bond issue is secured; date of mortgage securing issue; by whom made; upon what property; whether transferable into other forms; provision for default of interest payment; whether redeemable by sinking fund or otherwise; interest and principal to be paid without tax deduction; whether or not subject to earnings; bond signed or indorsed by trustee under mortgage deed

of trust; corporate seal; signed by officers of company; date; attestation by secretary of company.

Bonds are to be preferred in the following order:

1 Government, state and municipal bonds.
2 Railroad bonds.
3 Public utility bonds.
4 Industrial bonds.

Government, State and Municipal Bonds

Government, state and municipal bonds are promissory notes. No property is transferred to a trustee to be held in case of default.

Government, state and municipal bonds are divided into three general classes, each of which is again subdivided. No sounder security could be conceived than these bonds, still there are a few exceptions.

It should not be overlooked that after the Civil War a great many state

bonds were outstanding, originally issued by the Southern States, which have been legally repudiated and the holders of these bonds have lost their money. There is nothing better than United States Government Bonds, for they are regarded as one of the highest and safest forms of investment, but the meagre income accruing therefrom does not make them an ideal investment for the individual.

United States bonds are divided into two classes: registered bonds and coupon bonds. Registered bonds are registered in the name of the owner, and if such a bond is lost a duplicate will be issued upon presentation of satisfactory evidence. Bonds are transferable, but transfers or assignments must be witnessed by an officer of a national bank, custom house, or some similar federal official. These bonds may be exchanged for coupon bonds, but there is no law compelling such an exchange.

A coupon bond, however, is payable

to bearer and anyone presenting it is recognized as the owner. This form is generally preferred by individual investors. Bonds should be kept in a safe place, preferably a safety deposit box, for the coupons, if detached, are the equivalent of money.

The Federal Government requires national banks to buy registered government bonds and deposit them with the United States Treasurer to secure the circulating bank note issue, in amount equal to the paid up capital of such national bank. United States Government Bonds are also received by the Government as security for United States deposits.

The federal government assumes no risks and when one sees the statement displayed by any bank "United States Depository" it does not signify the unusual strength of such an institution, but it means that the bank has bought and deposited with the United States Treasurer bonds equal in face value to the

moneys deposited by the United States government. It indicates that the bank has met all requirements prescribed by law to receive United States deposits. Should the deposits exceed the amount of bonds deposited, the excess must be immediately forwarded to the nearest United States Sub-Treasury.

State bonds are issued by the various states and are well within the lines of the safety market. They possess the very desirable feature of being exempted from taxes.

Municipal bonds embrace: city bonds, bonds of incorporated towns, bonds of incorporated villages, county bonds, township and borough bonds, assessment and special tax bonds, *et cetera.*

The selection of these bonds is more difficult. Municipal bonds may run for a full term or may be retired serially, that is, at different dates. Bonds of larger cities are preferable to those of smaller towns on account of the inability to market the bonds of the latter.

The investigation of municipal bonds should cover the following points: Has the strict conformance to certain legal requirements been properly established? Has the town a stable or floating population? Is there any reason why the real estate valuation could be fluctuating? Are the bonds tax exempt? Are they a regular obligation of the community or are they special assessment or special tax bonds? If they belong to the special assessment or special tax bond class, are they to become regular obligations of the municipality if the taxes collected which will benefit the property in question are not sufficient to pay interest or principal? If they are not to become a straight obligation of the municipality or if there should be reasons to fear some calamity might befall the town, such as "caving in" in mining districts, the breaking of dams, *et cetera,* they should not be considered.

Municipal bonds are looked upon as an excellent form of security and are

a favorite investment for bankers, life insurance companies, trustees who administer the money of other people, as well as private investors.

Municipal bonds are equally as safe as United States Government Bonds, for the holder may demand payment of principal and interest. These rights of municipal bondholders have been repeatedly established by the Supreme Court of the United States. Bear in mind that a city may be sued, but action cannot be brought against a state or the United States without its consent.

The issue of all municipal bonds is restricted, and payment of principal must conform to the statutes of the respective states. The accounting of municipalities is strictly required by law. There are, however, bonds issued by municipalities which cause a great deal of litigation and should be avoided. These are usually bonds issued by cities, towns, counties, *et cetera,* to aid in the

construction of railroads or in the establishment of new industries. This is unconstitutional in some states, as for example Illinois.

Only such municipal bonds as state specifically that they are legal and form a constitutional obligation of a community, should be bought. The total amount of the bond issue plus all outstanding indebtedness must not exceed the tax valuation of the property of the municipality.

There is no safer form of investment than United States Government Bonds. If the investor is satisfied with a small rate of interest, he need look no further, for he is safe beyond question and may realize the full value of these bonds at any time.

State bonds are very desirable and at once safe and attractive. They justify almost any amount of money, for they may be sold readily and always are good collateral.

Municipal bonds are rated as among the best possible investments. Select only those of larger cities, especially if you may wish to dispose of them quickly. It is good policy to buy home-town, county and borough bonds. In fact, there should be no hesitation, because the individual investor may satisfy himself easily about his own community. He is informed as to the taxation value, the legality of the vote taken to issue the bonds, *et cetera;* in fact, to all requirements prescribed by law.

These investments are generally for a long period and while these bonds are not as quickly salable as state or government bonds, one may at all times feel assured of the safety of his investment. Subsequent reverses are not to be feared. The advice of your banker will guide you in regard to the legal requirements and he can inform you if they have been issued in accordance with the state statutes.

Corporation Bonds

Corporation bonds will next be considered. These bonds fall into three distinct classes: Transportation, public utilities and industrial bonds. These three classes are again subdivided as follows: under transportation bonds come railroad, steamship and express company bonds. Under public utilities: street railroads, electric light and water power bonds, gas bonds, water bonds, telephone and telegraph bonds. Under industrial bonds: timber, coal and mining bonds, irrigation bonds and real estate bonds.

Corporations are empowered to borrow money and to issue bonds. However, there is a prescribed limit upon the amount which the corporation may borrow in most states. A corporation also has the right to issue unsecured bonds, but no corporation may issue perpetual bonds. The bonds must have a clause to the effect that the principal will be repaid at a stated time.

Nearly all corporation bonds have attached coupons which represent the interest on the bond itself and are usually payable semi-annually or annually. These coupons are a form of promissory note payable to bearer, specifying the amount of the coupon, the bank where payable, and signed by the treasurer of the company by means of an engraved signature. These coupons are negotiable.

It is always advisable to make the most rigid investigation of all offerings which come under the head of corporation bonds. While in the majority of cases they represent good and substantial investments, there are some which are merely speculations; some being merely promises to pay.

The principal questions to ask before investing in bonds are the following:

What is the character of the corporation issuing these bonds? What is the purpose of the issue? For what will the proceeds be used? Corporations are

permitted under the law to use funds obtained from a certain mortgage for some entirely different purpose, but this is restricted by statute in some states to the purpose stated in the mortgage, but bona fide purchasers will be protected. What is the security given in order to insure payment of principal? When will the bonds be retired? What is the sinking fund provision? What property has been turned over to the trustee to be held for the bondholders? Where are the coupons to be paid? What is the denomination of such bonds? What is the rate of interest? Has the legality of the bonds been approved by competent attorneys? What are the possibilities of prompt payment of interest? Are the franchises permanent? How about the right of way? Is the company under the supervision of a Public Utilities Commission, or if a railroad, The Interstate Commerce Commission?

There is a greater variety of bonds offered by railroads than by any other

corporation. The constant enlargement of these companies necessitates new funds continually. Each bond offered for sale must be carefully scrutinized. It is not possible to generalize in these securities. The best guide, however, is formed by the two following questions:

Has the corporation, or the undertaking for which this bond is issued, existed a sufficient length of time in order to enable it to make specific claims as to its earning power? Is it in the state of construction; that is, is it undeveloped or not long enough in existence so as to permit the forming of conclusions?

Subdivision of Railroad Bonds

Railroad bonds are subdivided as follows:

1st: Collateral trust bonds, railway trust bonds, collateral notes, collateral mortgage bonds, mortgage collateral trust bonds, first mort-

gage trust bonds, collateral income bonds and trust certificates. All these bonds are known to the trade as paper collateral bonds.

2nd: Car trust certificates, car trust bonds and equipment bonds. These bonds are known to the trade as rolling stock securities.

3rd: Railroad, real estate bonds, land grant bonds and terminal bonds. These bonds are known as property bonds.

4th: Divisional bonds, extension bonds, refunding and extension bonds, purchase lien extension bonds, bridge extension bonds, dock extension bonds, wharf extension bonds and terminal extension bonds. These bonds are known as mortgage incidents bonds.

5th: Prior lien bonds, underlying bonds, overlying bonds, senior issues, junior issues, first mortgage bonds, refunding first mortgage bonds, first refunding bonds, first

and refunding mortgage bonds, consolidated mortgage bonds, consolidated and refunding mortgage bonds, consolidated first mortgage bonds, first and consolidated mortgage bonds, first consolidated mortgage bond, general mortgage bond, first general mortgage bond, general and first mortgage bond, first lien and mortgage bonds.

6th: Debenture bonds and mortgage and debenture bonds.

It is impossible in limited space to give a complete account of the numerous bonds employed by the various railroads. No attempt is made in this work to give, in an elaborate, comprehensive manner, all the information pertaining to the different bond issues. Consequently only a few generally descriptive characteristics will be discussed, referring only to the most important points so that prevailing popular misconceptions may be cleared by creating an understanding of the peculiarities of

bonds and assist in making a proper choice from the host of offerings.

First Mortgage Bonds

Railroad first mortgage bonds are secured by a first mortgage on the finished part of a railroad. In order that the nature of this indebtedness may be positively determined and to establish the desirable qualities and superiority, as far as an absolute first mortgage is concerned, one should ascertain the precise text of the mortgage which is in possession of the trustee. A copy of the mortgage and legal opinion may always be obtained, but emphasis should be laid on the exact definition of the bonds, as the name "FIRST Mortgage Bonds" alone, indicates nothing, as most of them are really only secondary and follow prior and underlying lien bonds. They have lost the quality of security which appears in real estate mortgages.

Second Mortgage Bonds

On account of the inadequacy of the

original capitalization, second mortgage bonds are created. The original cost of the railroad could not be ascertained and the funds received from the first mortgage bond issue being exhausted before completion of the construction work as originally planned, supplementary financing must be resorted to and junior liens created. The several varieties of these liens are divided into consolidated and refunding bonds and are called second mortgage bonds.

First Consolidated Mortgage

Let us suppose a certain railroad is completed and actually in operation. In order to meet the rapidly increasing demand for transportation and to convert uncultivated sections into rich producing farms, the railroad has thrust upon itself the problem of further building and extending its lines.

The demand for money with which to finance extensions becomes such a burden upon the road that it is obliged to

create new funds. In such an instance the railroad overcomes the lack of capital by issuing a first mortgage on the next extension. The security attaching to the bond, a first mortgage on the unfinished or proposed extension, is not sufficient to make the bond attractive; consequently, in order to protect the investor and to meet the situation, a second mortgage on the already completed and operating section of the property is added to the first mortgage on the extension.

Similarly to the consolidation of mortgages, this new indebtedness receives its name — first consolidated mortgage bond.

Divisional Bonds

The need of money in railroad financing is almost without limit and often it becomes necessary to issue second mortgage bonds on the old property before an extension may be built.

In such a case a railroad commonly

resorts to a first mortgage on the additional mileage, considering the protection to the investor ample and attractive, thereby necessarily excluding a second mortgage on the old property. A bond so issued is called a divisional bond.

The first mortgage on the old property may contain provisions covering all future properties, and if such conditions are stipulated, the only solution is the creation of a new company and the bonds of this new company cover the extension only. The investor should ascertain the exact condition of these bonds in order to prevent buying a mere construction bond.

Blanket Mortgage Bonds

Railroads extend their systems from time to time so that the demands for transportation facilities of growing communities may be met. In order to handle the additional business, new tracks, spurs, stations, *et cetera,* must be

constructed. If all prior funds have been exhausted, the only method remaining whereby additional capital may be acquired is the creation of a mortgage to cover the entire property as well as the extension. This mortgage is subject to all outstanding mortgages. The security consists of a second mortgage on the extension, if the prior issue was a consolidated mortgage, or a third mortgage, if there was a first and second mortgage on the original property. These bonds are defined as blanket mortgage bonds.

Prior Lien Bonds

In explanation of prior lien bonds, let us assume that a company is financially embarrassed, due to mismanagement and miscalculation on the part of the officers, and because of this, further bonds are unsalable. Some means of meeting obligations must be devised so that the unavoidable, serious and deplorable state which may result in in-

solvency or reorganization may be escaped.

In such a predicament, a meeting will be called of the holders of all outstanding indebtedness, especially bonds, to devise some means to meet the emergency and at the same time protect creditors. It is reasonable to suppose that all the holders will conclude to pass a resolution authorizing the directors of the railroad to issue a new bond, called a prior lien bond. The funds raised therefrom will adjust all difficulties.

The holders of such prior lien bonds have a decided advantage as their interests are well protected and because such bonds, under the agreement entered into by the bondholders, are to be paid and retired before any others. However, prior lien bonds cannot be issued without the unanimous consent of the holders of all the bonds issued, as by this arrangement they impair the security of their holdings, their bonds depreciate in value and their indebted-

ness automatically becomes secondary; but it is usually stipulated that prior lien bonds are to mature as quickly as the finances of the railroad will warrant such action. In this manner bankruptcy may be avoided.

Underlying Bonds

The term underlying bond, as the name implies, has reference to a bond which enjoys a degree of protection lacking in subsequent issues. The owner of these bonds is assured payment when holders of subsequent issues may lose. That is, underlying bonds are created first in point of time, and such being the case, they are prior liens and are paid first. Subsequent bonds are subject to them. Underlying bonds of corporations which issue regular annual reports and which have been active for at least twenty years should be preferred.

Holders of underlying bonds must have satisfaction at all events, even

though it be to the prejudice of the holders of junior securities. For this reason the market value of junior bond issues should be determined.

Preference of Above Bonds

Of the bonds so far discussed the intrinsic value of first mortgage bonds of large railroads is greater than that of any other bond and a very safe investment, especially when they include all the properties, franchises and other special rights.

First mortgage bonds on new properties are more or less hazardous. Even though they are called first mortgage bonds, they are in reality construction bonds. These bonds are not regarded as a staple investment and it is therefore seldom good policy to buy them.

Prior lien bonds constitute an excellent investment. Necessity obliges the holders of the older bond issues to protect prior lien bonds. For those seek-

ing a good investment these bonds are recommended.

A consolidated bond, when issued by a large corporation of established reputation, may be accepted as a fair investment, as it is substantially backed by various other following mortgages.

One can, as a general rule, be guided by the rate of interest which a bond pays. The best ones, those tested by time, will yield only a small interest, and if a greater return is desired a larger risk must be assumed. There are naturally buyers for all bonds, as many investors prefer securities affording opportunities for speculative gain.

Convertible Bonds

The demand for money may develop very suddenly and at most inopportune times. Business may be languishing and capital hiding its resources, causing a severe depression or panic. At such times high interest rates are demanded. The situation is a difficult one with

which to cope, and in order to protect other investors, convertible bonds are issued.

The advantage of these bonds is that they may be changed at a later date for stock. As an illustration let us assume that this convertible bond bears the same rate of interest at the time of issue as the stock of the railroad. In the more prosperous years which follow, the dividend rate on the stock may increase considerably. The bondholder has the right to exchange his bonds for stock and to participate in the earnings.

Convertible bonds are very seldom secured by mortgage, but may be very profitable to those who possess a detailed knowledge of stock exchange transactions.

Extended Bonds

When the date of maturity of the obligations of a company has arrived it is required either to pay them or redeem its indebtedness by extending its

existing bonds. If it has no accumulated funds, nor any means of meeting its obligations or, owing to the prohibitive interest rates prevailing during business depressions, the company refunds the old bonds by a new issue, known as extended bonds. The reason for issuing such bonds is that it does not wish to hamper the progress of the road to a great extent by borrowing at unfavorable times at exorbitant interest rates. These bonds are often classed as speculative bonds as the security back of them is not quite as substantial as others.

Sinking Fund Bonds

There is another group of bonds, called sinking fund bonds, which divide themselves into two classes. They are extended bonds with sinking fund clause and a straight mortgage obligation with a sinking fund provision.

A sinking fund is a sum set aside for the fractional discharge of the existing

indebtedness or the serial retirement of bonds. This constitutes a great protection to the bondholders but does not assure absolute safety. Such sums are usually paid to the trustee of the bond.

Sinking fund bonds are especially desirable and should be a requirement in most industrial bonds, such as timber, coal, quarry, mining, steamship, land grant, paper company bonds—in fact, in every bond where the property securing the bond will depreciate in value. However, the sinking fund is not of such great importance where the proceeds of the bond are to be used for the purchase of permanent undertakings which will eventually increase in value.

Callable Bonds

Any bond containing a clause reserving the right of total or partial redemption is a callable bond. It is usually decided by lot when and which bond shall be called.

Collateral Trust Bonds

Of the immense railroad systems existing today only a very few were built by one original company. The majority of systems have been built up entirely through the consolidation of various lines.

Collateral trust bonds, as they are termed, have served as a very effective aid in financing such consolidations. Under consolidation agreements the stocks or bonds of subsidiary or extension companies or branches of the railroad are deposited with a trustee as security for an issue of collateral trust bonds.

When such consolidations are made an opportunity exists to make a bond issue considerably larger than the actual value of the property. The temptation to inflate the value of the property acquired is often so convenient and is so frequently resorted to that one should use the utmost care in the purchase of

collateral trust bonds. Another distinct feature deserves mention. The interest payment of collateral trust bonds depends upon the dividends paid by the bonds and stocks mortgaged and deposited with a trustee. The purchase of these bonds is not advisable for those who depend upon the income to be derived at stated periods.

Guaranteed Bonds

Often a railroad purchases or leases another road and not wishing to issue collateral trust bonds, guarantees the outstanding bonds of the road so acquired. Unlike guaranteed stock, where only the interest is guaranteed, the principal as well as the interest is guaranteed in these bonds. The nature of the guarantee is stipulated. If the company, which adds its guarantee to the bonds, is of good standing, such bonds are, because of this additional security, looked upon with great favor and constitute a safe investment.

Equipment Bonds

There is another class of bonds known as equipment bonds. These bonds represent the immediate assets of the company as defined by the Interstate Commerce Commission. The equipment consists of steam and electric locomotives, passenger and freight cars, work cars, machinery and tools for construction or repair, ferry boats, steamships, *et cetera.* They are a direct obligation of the road or the company owning them secured by the aforementioned equipment.

When steady uninterrupted growth necessitates the enlarging of the equipment, the company pays for this on the installment plan; in other words, issues equipment bonds which are retired serially. These bonds generally contain a clause which states that the deteriorated or obsolete equipment shall be replaced.

In order that the bondholders may be protected from losses the equipment must be insured.

While equipment bonds do not represent a bonded debt, nevertheless they are good bonds to buy, especially since the railroads must have equipment and these bonds are issued to pay for it. There is no case on record where such a bond issue has defaulted in payments, even though the interest paid is somewhat higher than on mortgage bonds.

Terminal Bonds

As a means of more readily obtaining additional capital for the purpose of building terminals, railroads often mortgage the various properties belonging to them, such as stations, offices, shops, engine houses and connecting real estate.

First mortgages on these various properties secure the money so received, and the bonds issued are called terminal bonds. These bonds are very desirable, especially when the terminals are used by other railroads, as there is

an absolute assurance of their payment by means of the contracted rentals. A great deal of money is spent on terminals and their approaches by different railroads. These terminals when not used by other lines do not produce revenue and are necessary luxuries. These bonds are generally considered a good investment.

Land Grant Bonds

In the early railroad days when transportation methods were limited, the government came to the aid of the railroads and donated certain lands to induce them to extend their lines through undeveloped, sparsely settled territory. There existed little assurance of immediate return, as the prospect of a large volume of freight business was lacking.

When the railroads began building these extensions they did not offer the lands received from the government

for sale, as their value was not very high. Instead they mortgaged them for the purpose of providing funds with which to construct their railroads. Land grant bonds were accordingly issued so as to hold the fee for a future increase in value. In the course of time the country became settled and the anticipated increase in value was materialized. The granted tracts were sold, and with the proceeds, the outstanding land grant mortgage bonds were retired.

While very good, very few of these bonds are at present outstanding and consequently little thought need be given them.

Refunding Bonds

There are three ways of refunding bonds: first, by retiring the old bonds and authorizing a new issue. Second, retiring existing bonds and issuing short term notes in their stead. Third, by actual payment of cash.

Large railroad companies very often have a great number of bond issues outstanding, and in order to simplify their finances, they readjust them periodically by consolidating a number of the older issues of bonds, each having a different name, into one large issue by giving a new mortgage which combines all the outstanding mortgages. This new mortgage is known as a refunding bond mortgage.

As the different bond issues mature the holders are asked to surrender the bonds which they hold and to accept refunding bonds in their stead.

Refunding bond mortgages are reasonably safe in most cases. If the mortgage consists of all the property, franchises, charters, *et cetera,* which the company owns, the purchase of these bonds may be generally recommended.

Short Term Notes

Short term notes are of comparatively recent origin. The demand for

higher interest rates increases in the same proportion as does the cost of living. The largest and best railroad companies, when in need of immediate funds or having maturing obligations, attempt to avert the payment of excessive interest rates, and in anticipation of a lower rate, temporarily employ short term notes for this purpose. These notes are usually secured and, if so, may be regarded as safe.

There is, however, another kind of short term note issued for quite a different reason. Where the earnings for a period of years have been larger than the fixed expenses and the sale of stocks or bonds would not bring the necessary results, the company then tries to borrow in the open market. When notes are issued with the intent to avert financial difficulties they should be decidedly left alone. Notes of this kind are only a form of commercial paper, that is, promises to pay issued on the credit of the company. Should

such notes mature during times of depression it would spell absolute disaster.

Investors who anticipate buying short term notes should seek the advice of their bankers. Such notes bring a high interest return, but are very fluctuating in price. The selection requires a careful study of the financial condition of the companies issuing them. The inference to be drawn is that these notes should be evaded unless one is thoroughly conversant with such matters. Short term notes are also issued by municipalities at times to tide over their finances until such time as taxes are collected. These notes, however, are all taken by one or two banks and seldom offered to individual investors.

Steamship Bonds

Steamship bonds, as the name implies, are issued by steamship compa-

nies. They consist either of a first mortgage on all boats of the company, or on each individual vessel. They should be of serial maturity, as the value of ships decreases in time, and should have a specific clause pertaining to insurance in order to protect the holders of such bonds from losses.

The bonds based on mortgages of freight steamers are naturally more valuable than those issued on luxuriously equipped passenger liners, as the earning quality of a freight steamer is greater than that of a boat carrying only passengers, or one combining freight and passengers.

These bonds are not looked upon with favor by investors seeking conservative holdings.

Express Company Bonds

Express company bonds are issued by express companies and are first mortgages on all their property, includ-

ing franchises and charters. The earnings of express companies have of late fallen off considerably, due to the establishment of the Parcels Post. One should use great caution in buying such bonds.

Street Railway Bonds

Street railway bonds are usually first mortgage bonds issued by street railway companies. Their desirability as an investment depends greatly on the magnitude of the system, capitalization, management, the territory served, *et cetera.* The franchise, which is the life of such a company, should be a perpetual one; otherwise funds invested in such bonds are not very secure.

Street railway bonds of companies serving small communities enjoy only a local market and do not rank among the choicest issues, the only exception to this being bonds issued by large companies of good standing and stability

which operate several distinctive systems.

A most exhaustive investigation should be prosecuted in order to determine the exact standing of such companies before its bonds are considered for purchase.

Electric Light Bonds

Bonds of electric light companies should be judged by local conditions. They often rank very high and may be accepted as fairly safe, particularly those of companies which operate in the larger cities. These companies usually enjoy a monopoly and the business is well-nigh assured.

Water Power Bonds

In the selection of water power bonds as a form of investment the greatest care should be exercised. While the large majority of such bonds are very

good and yield a higher rate of interest than railroad securities, yet issues appear at frequent intervals which are not very desirable.

It is imperative that one becomes thoroughly acquainted with all the affairs of companies the purchase of whose bonds is under contemplation.

Water power companies are divided into two classes: companies generating power and selling electric current at wholesale to other electric light companies, and water power companies, connected with electric light companies which generate electricity and sell the current directly to the consumer.

Electric power in itself is worth practically nothing unless the plant generating it is located in a well settled community or in a place where the distance to such community is not too great.

The radius in which electric current can be profitably transmitted is approximately two hundred miles. Therefore, the important feature to which to

look when buying water power bonds is the absolute conviction that a satisfactory market for the current, within the prescribed radius, is assured.

In order to insure the economical operation of water power companies, great dependence must be placed on factories which consume the surplus power. Selling current for lighting purposes only will not allow the accumulation of necessary sinking funds and at the same time pay dividends, because the gross consumption of current is too low. In other words, the current consumed by factories in the day time must be equalized by the night consumption for lighting purposes.

Complete information concerning water rights and privileges of water companies is essential. Attention is directed to the fact that minimum water stands should be known for a series of years past, in order to be assured of a sufficient flow during long dry spells. To ascertain such water stands, reports

from the state as well as the United States Geological Survey should be obtained. These are free of cost.

The water stand of July, August, December and January should be taken as a guide to determine the minimum amount of water in such lakes, rivers and streams as may be used in the operation of the plant at all times.

Auxiliary steam power is positively necessary where the water supply cannot be absolutely depended upon, especially in districts subject to droughts. It would be a great handicap for companies having an extensive market for current to be unable to give efficient service at all times. Accidents may happen, and should no provision be made against such contingencies, the service must be interrupted, resulting in considerable loss, even in the loss of the charter, where service is discontinued for a time.

The building of dams is another important consideration. Dams should al-

ways be built of rock or cement. Wooden dams are unsatisfactory and undesirable, especially for large projects. In constructing dams it is quite necessary that the ends are securely anchored to avoid "wash-outs" in floods, and also expensive delays and losses.

There are other lurking dangers in water power bonds, one of the more important of which is the over-capitalization of the company issuing them. The other is the issue of bonds while the dam and power plant are under construction, making a rather hazardous investment.

Construction work is not income producing. The undeveloped state of construction work does not give a guarantee of the potential earning capacity. Therefore, no guarantee may be given as to the payment of interest or security of principal of the bonds of companies whose plants are under construction.

Gas Bonds

Gas company bonds should only be bought of companies operating in large cities where they serve a great population. Gas cannot be sold at a profit if the company operates on a small scale.

It should be remembered that gas companies have been revolutionized in late years because of the competition of companies furnishing electric power, which is used for fuel as well as illuminating purposes. There are two kinds of gas companies, those which supply natural gas and those which manufacture and supply artificial gas.

Water Bonds

Bonds of water companies make very desirable investments. Water is a raw material and free of cost. Competition is reduced to a minimum, for water companies generally enjoy a monopoly.

Bonds of such companies suffer but

little depreciation and are usually purchased by people living in the community where the companies operate.

The quality of water must be absolutely pure and the assurance must exist for a steadily increasing demand pro rata to the increase in population. Water companies are operated either by gravity, this being the most economical, or by a pumping system, which is more expensive to install. Water bonds are usually good, yet some of doubtful value are in existence.

Telephone and Telegraph Bonds

Bonds of telephone and telegraph companies, especially of the larger ones, are considered quite desirable since these bonds represent a very useful and essential necessity. Securities of the Bell Telephone Company, Western Union and Postal and all their subsidiaries are preferred to the issues of smaller companies operating in a limited territory.

Timber Bonds

Timber bonds are not considered a good risk because of the ever-prevailing danger of forest fires.

The timber value is usually gauged by its location. Timber which is remote from transportation facilities is of no great value. Timber bond issues should at all times provide for a sinking fund and the mortgage should include all of the company's assets. A great many of these issues are even personally guaranteed by those interested in the company. Special stress should be laid on clear titles.

As an exact determination of the value of the timber is necessary, a certified impartial appraisal should be furnished. Only experienced, well-known cruisers should be employed. Cruising means an appraisal made by experienced lumbermen who go through the forest and make an estimate of the standing timber.

The security in timber bonds rests on the actual amount of timber. If the forest is located in Canada one should ascertain whether it is owned in fee. The Canadian Government does not sell timber lands but only licenses its cutting and removal.

Coal and Mining Bonds

The appraisal value of the property which secures coal and mining bonds is not easily determined. The quantity of raw material may only be ascertained approximately.

These bonds are not considered a sound investment and should be avoided by those seeking dependable, conservative securities.

Irrigation Bonds

Irrigation bonds are not the best form of investment as in the past many of them have been defaulted. While there

are some real good outstanding issues, it is seldom good policy to invest in them, many investors refusing even to take them into consideration.

CORPORATIONS

CHAPTER III.

Corporations

A corporation is best defined as an artificial being, invisible, intangible, and existing only in contemplation of law. It is, in all its rights and privileges, almost identical to a natural person.

Corporation Laws

Every state, as well as the United States, has its own laws governing the incorporation and operation of companies. Some states have restrictions which are of great benefit to the stockholders, while the statutes of others are more liberal and do not provide as many safeguards. For this reason it is important to determine the state in which the company is incorporated.

Organization

The first step in the organization of a corporation is an application to the secretary of state, making a statement as to the object of the proposed corporation, amount of capital stock, *et cetera.* This is usually done by three or more individuals called commissioners, to whom, when all statutory requirements have been complied with, the secretary of state by virtue of the authority vested in him by law, issues a certificate of complete incorporation and a license to do business, known as a charter. The procedure varies somewhat in the several states.

A corporate charter may be granted under the general laws, special laws, or in the case of public utilities and state banks by the state legislature in some states. All charters for national banks are granted by the federal government.

Private Corporations

There are two classes of private corporations, domestic and foreign. A domestic corporation is one operating in the state in which it is organized. A foreign corporation is organized under the laws of one state and operates in that and other states.

Charter

A charter prescribes the powers of a corporation which are necessary to properly conduct the business, and stipulates the authorized capital. A corporation has no power except that granted in its charter and such powers as are necessarily implied from the nature of its business.

While the name, the authorized capital, *et cetera,* may be changed, there can never be a change as to the object for which a corporation is organized. A corporation whose charter states for its object the generation of electric

power, cannot manufacture ice, shoes, *et cetera.*

Certificate of Incorporation

A certificate of incorporation is, in so far as the powers of the corporation are concerned, restricted to the laws of the state in which it is organized; but a foreign corporation may operate in any state where it has complied with the laws of that state.

Issue of Stock

The issue of stock means the issue of certificates. A share of stock is evidence of the interest which the holder has in the corporation. The face value of stock represents the money or property paid in.

It is ordinarily divided into equal shares of a determinate value and issued to the stockholders in proportion to the amounts which they have paid in, or for which they are liable. The capital stock and the value of each share is fixed by the corporate charter.

Share of Stock

A share of stock is *participating and bears no due date.* A stockholder is entitled to one vote for each share of stock held, in the choice of directors, who are, in turn, entrusted with the management of the company, unless definitely stated otherwise.

A share of stock has no definite income but participates in the profits in the form of dividends. The principal is *never* realized except upon the dissolution and winding up of the corporation.

A share of stock has, however, many qualities of negotiable instruments and can be sold, transferred and assigned; but this transfer or assignment must be recorded on the books of the company.

Two Classes of Stock

There are two classes of stock, common and preferred. Preferred stock usually receives a stipulated percent of

the earnings, known as a dividend. This must be paid before the holders of common stock are entitled to anything; but if the company's earnings are not sufficient to pay the preferred stockholder his dividend, he receives *nothing until* the earnings are large enough to pay the prescribed amount. A dividend is only payable and demandable when actually earned and declared by the board of directors.

It is sometimes provided that after the common stock has received a dividend equal to the preferred, that then both common and preferred are to share equally in the surplus.

Some preferred stock has a cumulative interest. Assuming that the interest is omitted, passed or reduced semi-annually or annually, as the case may be, and the company's earnings have not been sufficiently great to warrant a dividend, the yearly amount of the stated dividend of the preferred stock accumulates, and this total amount of

dividends must be paid on a subsequent date.

Stock may be an investment or a speculation, depending entirely upon the company issuing it. A stockholder is liable only to the extent of his unpaid subscription, unless the certificate provides for assessments.

There are, however, corporations where the law renders the stockholders liable, as is the case in all banks stocks where the liability is double the amount of the stock.

The stockholder has no legal title to the property or profit of a corporation until a dividend is declared or a division is made on the dissolution of the corporation; but the preferred stock cannot participate in any increased value of the principal unless expressly so stipulated in the certificate.

Right to Vote Stock

Stockholders have, as already mentioned, a vote for each share of stock

at any meeting. At stockholders meetings the affairs of the company are reported, financial conditions discussed, directors elected, *et cetera.*

The election of directors is very important as the law vests absolute power in the board of directors and the stockholders cannot interfere except in the most unusual cases. The directors in turn vote on and elect the officers who are entrusted with the actual management of the corporation.

Preferred stock may be retired, that is, it may be called in, at certain periods at the election of the board of directors, if so stated on the certificate.

Reports

Every corporation is compelled by law to make reports concerning its financial condition at regular intervals, usually annual, to the state or federal authorities.

Preferred Stock

Preferred stock is the class of stock commonly offered for sale to the public. There seems to be a great deal of misunderstanding relative to the intrinsic value of preferred stock. An assumption prevails that preferred stock is an obligation and that the principal is guaranteed, or that it carries a lien or mortgage. Preferred stock has certain privileges but is *never* protected by any form of collateral.

The greatest care must be exercised when purchasing perferred stock. One must be familiar with the questions on pages fifteen to twenty-five in order to analyze the relative merits of this stock. Systematic investigations of all such offerings must be rigidly pursued, for this has a very decided bearing on your future success or failure. Under no circumstances should this be overlooked or slighted as it is more necessary in securities of this kind than in any other.

Preferred stocks very rarely possess the qualities which constitute an ideal investment. Stocks, whether preferred or common, listed or unlisted, should rarely be bought where an entirely safe investment is desired.

On the one hand there is constantly a great fluctuation as to principal, while on the other there are stocks which, while speculative, may be considered as an investment; some of these are stocks of the Delaware, Lackawanna & Western Railroad, American Telephone & Telegraph Company, and still others in which the principal as well as the interest is safe, such as Ford Automobile Company, Royal Baking Powder Company, Swift & Company, *et cetera.*

Guaranteed Stocks

There are, however, guaranteed stocks. Holding companies or railroads often come into possession or control of other companies. When such a transfer occurs an agreement is usually

entered into, to the effect that the parent or holding company shall execute what is commonly known as a guarantee of the stock of companies acquired or controlled.

Obviously such a guarantee merely represents the prompt and continuous payment of dividends, rather than a guarantee of the principal. Such a guarantee agreement could not possibly extend beyond the payment of dividends, as no one can forecast the value of the assets at the termination or dissolution of such acquired companies.

Difference Between Bonds and Stocks

Bear in mind that there is a great difference between a bond and a share of stock. Stock is not an acknowledgment of indebtedness, while a bond is. In order to clearly establish the value of such a guarantee it is essential that the character of the parent or holding

company should be excellent and its financial condition strong enough to give assurance of payment, otherwise, the liability assumed and the guarantee given by the endorsement of the parent or holding company would be worthless.

Stock Exchanges

Stock exchanges are located in every large city in the United States, as well as in European cities.

Stock exchanges provide a ready market to investors for the immense quantity of indebtedness, such as bonds, stock and notes, which exists today.

Listed securities are entitled to more consideration because the public has a fair assurance that it is thereby partially protected from fraudulent misrepresentations. As outlined in the following paragraphs, the rules and regulations of the various exchanges are strict and by the very fact that securities of a corpo-

ration are listed, the public will have a reasonable assurance that the corporation is being operated and conducted on a fairly clean basis.

Rules of Stock Exchanges

There are many rules concerning listed securities which protect the investor, to a great degree, from losses growing out of irregularities and frauds which are sometimes resorted to by unscrupulous promoters and speculators.

Stock exchanges require, before listing securities, that statements be filed with them, which are carefully examined, concerning the location and description of the property; the organization of the corporation; authorized capital stock; number of shares; officers and directors; its franchises and equipment; assets, liabilities and earnings; the amount and description of mortgage liens and other indebtedness on leases, guarantees, rentals, *et cetera,* and the terms of payment. Copies must be

furnished of trust deeds, mortgage and other corporate agreements, as well as a certified balance sheet and statement. Also, a certificate from an expert civil engineer describing the actual physical condition of the property.

Application for Listing

When application is made regarding the securities of a corporation which has been reorganized after insolvency, stock exchanges require a full and complete financial statement of this corporation covering a period of one year prior to reorganization; a detailed statement of earnings and receipts from every source; a detailed account of all expenditures; the amount of all outstanding indebtedness; a balance sheet of the reorganized company; amount and description of the various securities issued; the purposes and terms of the reorganization.

If the property has been disposed of by order of court, copies of the order

confirming such a sale, together with the history of the proceedings, must be produced. A certificate from counsel stating that all legal requirements have been complied with and showing beyond a possible doubt that the title to the property is fully vested in the new corporation, free from all liens and encumbrances, except such as are specified and issued by the reorganized corporation, must be submitted. When bonds are issued to replace other authorized prior issues, evidence of satisfaction of such prior liens or a cancellation of retired bonds, is a condition precedent to listing.

If additional amounts of securities are to be listed a statement of the amount and the character of the additional issue, the authority therefor and the application of the proceeds must be shown. If new properties have been acquired, these must be described in detail. If any property has been mortgaged a certificate of the county clerk

of each county, showing where the mortgaged property is located, must be produced in order to prove that a mortgage has been recorded. Sometimes a certificate from the secretary of state is necessary to prove the record of mortgages in several counties.

A copy of the charter and by-laws of the company must be filed, together with a copy from counsel showing that the company has been legally organized, securities legally issued, *et cetera.* These and other details which tend to protect the individual investor are necessary in order that securities may be listed.

There is a distinction between listed and unlisted securities, both kinds having their advantages as well as their disadvantages.

Unlisted Securities

Unlisted securities are sold independently of the stock exchange and, while

not as quickly salable as those which are listed, are not subject to fluctuation and manipulation to as great a degree as the latter. Very often they constitute quite satisfactory investments, especially when issued by substantial, well regulated companies and sold by houses of established reputation.

Many prosperous companies which command the highest respect and are able to point to a number of years of successful operation, do not wish to incur the expense of listing their stocks and bonds. However, the financial statements which they publish at regular intervals should indicate and reveal the fact that their affairs are regular and that no reverses have been experienced; that the earnings are constant. In such companies the most economical methods of operation and the conservative management are almost absolute assurances that the money invested is safe, and that the investment itself is desirable. For instance, the stock of

the Standard Oil Company has never been listed, yet it constitutes a highly profitable investment.

There is absolutely no advantage in buying listed securities when seeking an investment to extend over a period of years. If marketability does not enter in as an important factor, one may often obtain greater returns without sacrificing the security of principal.

One point in favor of listed securities is the small commission which must be paid in case of buying or selling. This commission is naturally larger on unlisted securities as it is more difficult for the broker to locate a buyer at the proper time. This, however, should not be an objection when buying unlisted securities, especially when the selection is made with the intention of holding them as a permanent investment.

MORTGAGES

CHAPTER IV.

Mortgages

In making investments it is well to bear in mind whether or not the property purchased may be readily and quickly disposed of. For this reason real estate mortgages may be classed with the less desirable because of the slow, tedious operation necessary to recover the principal in case default is made.

Should a mortgage debt not be paid at maturity it becomes necessary to commence foreclosure proceedings. There is some misconception concerning these proceedings, for a common belief seems to exist that when the time of payment of the mortgage debt has arrived and the mortgagor has failed to

pay, that the mortgagee may then take possession of the land and sell the same. This is not quite the case, for in most states the mortgagor has a specific period of time, usually one year, in which to redeem after he has failed to meet his obligation. Thus, instead of having possession of the land from the day of default by the mortgagor the mortgagee must often wait from sixteen to eighteen months before he receives full satisfaction.

Notwithstanding this inconvenience and delay, however, the money invested in real estate mortgages, if the precautions outlined in this work are taken, is quite safe and secure. The investor need have little fear, for the price and value of real estate is not subject to frenzied fluctuations. Its value is steady and rises or falls gradually and in proportion to the nature of local conditions, such as, street car extensions, opening of new sub-divisions, building of factories, saloons, *et cetera.*

In taking a mortgage, the laws of the state should be carefully investigated, as the rights of the parties thereto vary materially in the several states. Their right to possession, to the manner of foreclosure, to the rents and profits, to demand repair of the mortgagor, *et cetera,* are almost entirely regulated by statutes and must be followed.

The investor should look to the record books and ascertain the nature of the title of the property to be mortgaged. There may be an existing mortgage and the rights of the first mortgagee are then superior to those of the second. The title to the land may be in dispute, or others may have rights over the land, but not to the land itself. In farm mortgages, especially, the crop may be mortgaged, or in income property the rents may be assigned or mortgaged. If the instrument making the assignment or mortgage is not recorded, then little fear need be entertained, for the first record-

ed mortgage generally takes priority over other unrecorded instruments. It is, therefore, essential that the mortgage be recorded at once after it is made.

Conservative saving banks will loan on real property to about 60% of its value. If the investor is in a position to make a personal investigation he should do so by all means, always bearing in mind that in making a mortgage he is at the same time a conditional purchaser.

First Mortgage Real Estate Bonds

A first mortgage real estate bond is to be preferred to a real estate mortgage because bond houses of established reputation critically and carefully examine every point tending to the safety and desirability of making such loans. Investors buying first real estate mortgage bonds, from conservative, reliable firms, have not the cares coincident with

a mortgage, such as collecting interest, taking insurance and making repairs.

First mortgage bonds do not, as a general rule, enjoy a quick sale because of their analogy to mortgages; but they form a safe investment. Persons wishing to employ their funds for a term of years often select such securities.

Two Classes of Real Estate Bonds

Two classes of real estate bonds should be distinguished—mortgage and debenture bonds. A debenture bond covers only the equity in the property or the income of the same and is but a mere promise to pay.

For years a New York real estate company has been very successful and most prosperous in its real estate operations. It owns desirable, developed property, which shows good earnings; its property is impartially appraised yearly; its books are properly audited, and financial statements are easily pro-

cured; the management has been and is excellent. It has returned a great deal of money to investors, representing a quantity of bonds, in coupon form, of convenient denominations, and bonds payable in installments. These bonds, though they are only debentures, enjoy a good reputation and are eagerly sought by a great many investors because of their high rate of interest.

Several other concerns of comparatively recent origin have imitated the methods of this old and successful firm and have introduced a similar bond. The property acquired by the imitating real estate firms was of inferior, unestablished value and for the greater part undeveloped. Their methods were reckless and questionable and bordered on high finance, consequently serious losses have resulted by reason of the failure of such concerns.

However, the state of New York has lately passed laws which place restrictions on companies issuing real estate

bonds, thereby greatly protecting the interests of investors.

Buying Real Estate

When buying real estate as an investment, the same care should be exercised as in the case of a mortgage. Buying lots in new additions or subdivisions, ore and timber lands, worn out farms with the hope of building them up, are all rash speculations and we should advise decidedly against such purchases, except perhaps after the most exhaustive and rigorous investigation.

Buying Improved Income Property

When buying improved income property, or in making a mortgage on such property, the present and prospective value should be considered, together with the probability of vacancies, insurance, local conditions, repairs, taxes, payment of rents, troublesome tenants, *et cetera.*

Bear in mind the following cardinal principle when buying real estate or making a mortgage. If in any way possible *personally* inspect the property and acquaint yourself with local conditions; but if this cannot be done send some representative in whom you have implicit confidence and trust, who may appraise the same impartially. Proceed only when satisfied from your own point of view, disregarding the velvet arguments and possibilities suggested by the person selling.

A comparison of the relative advantages between mortgages and real estate bonds leads to but one conclusion. Mortgages are good investments when the purchaser is thoroughly acquainted with the value of the property, the character of the owner and is absolutely assured of a clear title. The title of the mortgaged property should be insured by a title guarantee company.

Real estate bonds, which are secured

by a first mortgage, when issued by reliable, responsible houses, constitute a very satisfactory investment in every respect. They are to be recommended because of the high rate of interest which they bear, as well as the non-fluctuating qualities of the principal.

Real estate bonds, which represent debentures, must be very carefully selected and one should be absolutely satisfied as to the conservative methods of the companies issuing them. The financial statements of such companies together with the management should be beyond suspicion, otherwise an investment in such bonds may prove disastrous.

PARTNERSHIPS

CHAPTER V.

Partnerships

To the man who wishes to enter into a partnership for any purpose, other than professional, such as law, medicine, dentistry, *et cetera,* it may be well to state that partnerships are not the ideal manner in which to conduct business in this age. They are an institution of the past. They are obsolescent, for they no longer fulfill the requirements of present day business and manufacturing enterprises.

Although partnerships are entered into daily, they are to be discouraged because of the great inconvenience of doing business through them. Be the enterprise ever so small, a corporation should be formed to carry it on. The

reasons for this are numerous and all important as will be briefly outlined below.

In the first place, the life of a partnership is limited. If one partner dies the partnership comes to an end automatically. There is a winding up of its affairs. When the debts have been paid and accounts collected, the assets remaining, if any, are distributed, unless otherwise specifically stated in the partnership agreement. In a corporation this is not the case, for the corporation is a being in itself. It cannot die, for its life is limited only by the time mentioned in its charter, usually ninety-nine years; or by voluntary dissolution or by dissolution on the part of the state.

In a partnership each partner is liable for the entire debts of the concern. Each partner may bind himself and his co-partners to any amount, when acting on partnership business, making them all liable. Such liability does not

exist in corporations. The stockholders are only liable to creditors to the amount of their unpaid stock, but no further. The corporation itself is liable for its debts. The corporation being separate and distinct from its stockholders, the latter cannot bind the former in any way. Only the officers, elected for that purpose, may do so, but only to a limited extent, usually to the amount of its capital stock.

If the business dealings and principles of a partnership are not satisfactory to all the partners and they cannot come to an agreement, the only course remaining is a dissolution and winding up of the affairs of the firm. In a corporation this may be overcome by electing a new board of directors, who in turn elect the officers.

If one partner becomes insane the firm is thereby dissolved. In a corporation all of the directors and stockholders may become insane, but the corporate being still remains.

Again, where great enterprises are to be undertaken, the infeasibility of a partnership may readily be understood. The burden would be too great upon a group of three or four men to finance and bear the responsibilities of an enterprise involving a million dollars or more; whereas in a corporation, which may comprise any number of persons, the individuals would be relieved and the corporation itself would assume the burden.

With the exception of a very few occupations any enterprise may be incorporated. The cost of so doing is small and the attendant advantages are so great that any person expecting to enter into a partnership should first investigate the opportunities for incorporation and then proceed. If the parties with whom one intends to become associated refuse to allow incorporation and have no cogent reason for so doing, it is best to hesitate.

CONCLUSION

CHAPTER VI.

Remarks in Conclusion

The opinions of men qualified to judge investments differ decidedly. Persons have likes and dislikes. One may buy municipal and railroad securities, another public utilities or industrial corporation securities, still another prefers short term investments. Each investor must determine for himself the character of securities which are best suited to his individual requirements and tastes.

There will be little difficulty in selecting a good investment, and the knowledge required to do so will be readily gained, if the principles outlined in this work are carefully and studiously applied. "Safety First" in this case means a real investigation first.

Test all offerings by applying every question found on pages fifteen to twenty-five in addition to the special suggestions and advice given. Buy only seasoned securities which produce a continuous and steady income. Hard and fast rules cannot be established for the wide range of investment offerings; but if the many pitfalls which are pointed out in the foregoing pages are avoided, one may proceed with a reasonable degree of assurance of being properly guided, especially if only reliable bond dealers are selected.

In order to determine the value of bonds personally, one should inquire of a bank, which is located in the neighborhood of the property securing the bonds, as to its value. Apply such questions as may assist you in your determination.

Attempt to make a loan, with the security which you expect to select as collateral. In this manner you may obtain the banker's true opinion as to the

value of the bond. Eliminate every form of investment which may not be used as collateral. The best evidence of the value of a bond is the amount which may be loaned when it is placed as collateral security.

Employ your money in undertakings within your own community or state. Investigation is thereby facilitated, for you should be more familiar with local conditions and circumstances surrounding such enterprises. You will be in a position to protect your investment after it has been purchased.

Never Buy if a company does not make public everything in regard to its finances and all of its affairs in respect to holdings, subsidiary companies or connections which it may have with other companies, in any way, shape or form. A short time ago a great many banks suffered severe losses through their inability to thoroughly analyze the statements of

a company whose paper they held. This company showed an apparently clean balance sheet which did not, on its face, give sufficient information concerning the indebtedness assumed for its subsidiaries. You should be able to analyze the financial statements of corporations, intelligently and understandingly. The inability so to do may and often does, prove a great pitfall, even to banks, as above illustrated.

Never Buy if a company is over capitalized. This is axiomatic. Over capitalization acts as a millstone which decreases earnings and shows inflated fictitious values in regard to holdings, machinery, equipment, *et cetera.*

Never Buy if the rate of commission which a company pays to its fiscal agents is unusually large, or if a company is attempting to eliminate competition and establish

a monopoly. This ordinarily causes the payment of enormous prices for property acquired to eliminate competitors.

The net earnings of a company should be carefully scrutinized and ascertained for a number of years previous to a bond issue or to the issue of additional stock. Earnings should be equal to at least three to eight times the interest on the issue. In the case of public service or railroad bonds from three to four times the amount, and in industrial offerings from four to eight times.

A great many attacks have been made in recent years on the administration of railroads, public utilities and other corporations. This period of muckraking has depressed the security market. The result, however, has been wholesome.

The many abuses of which these corporations have been guilty in the past are now practically overcome. This re-

form wave is almost spent and railroads have shown themselves exceptionally responsive to the demands of the public and the suspicion, previously existing, has been replaced by a feeling of confidence and trust. Shiftless and unscientific methods have been discarded. Extravagance is now absolutely prohibited and the formidable movement tending to regulate their actions has been a success.

The Interstate Commerce Commission has been created and is active in regulating and prescribing equipment, methods, rates, *et cetera.* While these regulations were at first considered unusually drastic, the result seems to be satisfactory to everyone concerned.

Public Utilities Commissions have taken the place of the Interstate Commerce Commission, in regard to railroads, where the latter has no power to act. They supervise public utilities corporations and have been influential in establishing cleaner financial meth-

ods of all such companies; thereby unquestionably strengthening their securities.

Laws have been enacted for the closer scrutiny of the actions of corporations. Investments in the larger and better known companies may be made today with a great deal more confidence than was possible before the creation of the various commissions and laws above mentioned.

Government ownership of railroads and public utilities is far from realization in the United States. Because of the inferior service given by such institutions in Europe, where nearly all public utilities are owned and operated by the government, and because of the superior conveniences, equipment, service, *et cetera,* which we have in the United States, government ownership of public utilities is something which may be realized in the distant future.